

T-1715

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

GAO Findings On Federal Internal Audit--A Summary

Although Federal internal audit organizations save the Government billions of dollars each year, recent GAO reviews of such organizations disclosed some problems, including insufficient

- financial auditing,
- computer auditing,
- grant and contract auditing, and
- quality testing of audits and grantee records.

In addition, followup on audit findings has been poor and fraud identification was for many years a low priority. Lack of adequate staff contributed to most of these problems.

Legislation creating Offices of Inspector General has upgraded the audit organizations of most major departments and agencies. GAO is summarizing the results of its reviews of internal audit organizations made during the past 4 years so that the new Offices of Inspector General and other internal audit organizations can improve their audit activities.



FGMSD-60-39

MAY 27, 1980

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

GAO FINDINGS ON
FEDERAL INTERNAL AUDIT--
A SUMMARY

D I G E S T

Federal internal audit organizations save the Government billions of dollars each year. However, not all their work is as effective as it could be, and internal audit problems have kept the Government from realizing the full benefit of their work. During the past 4 years, GAO has issued 70 reports on these problems. This report summarizes these problems so that the new Inspector General Offices and other internal audit organizations can improve their audit activities.

Problems in Federal audit organizations included

- low priority on preventing and detecting fraud,
- insufficient financial auditing,
- inadequate and insufficient audits of grants and contracts,
- a need for more computer auditing,
- poor followup on findings, and
- insufficient staff.

LOW PRIORITY ON
FRAUD PREVENTION AND DETECTION

Fraud and abuse in Federal programs has increased sharply in recent years and has heightened the need for internal auditors to act as deterrents in fighting this problem.

Before legislation creating Offices of Inspector General in most major departments and agencies, fraud prevention and detection

Tear Sheet Upon removal, the report
cover date should be noted hereon

FGMSD-80-39

received little attention by Federal audit organizations. To meet the increased challenge of detecting fraud and abuse that the new legislation poses, auditors and investigators need better training. (See ch. 2.)

INSUFFICIENT FINANCIAL AUDITING

Financial audits of the Government's assets, liabilities, revenues, and expenses have been inadequate. Federal units with annual funding exceeding \$20 billion told GAO they had not received financial audits during fiscal 1974-76 although 58 of these reported they had received nonfinancial audits. Also, some agencies spend most of their audit time on grants and contracts. As a result some internal coverage, particularly financial, has not been adequate. (See ch. 3.)

INADEQUATE AND INSUFFICIENT GRANT AND CONTRACT AUDITING

Federal grant and contract funds are particularly susceptible to exploitation through various means, such as false claims, bribery, and collusion. Even though grant audits have received more emphasis than internal audits, recent GAO reports indicate that many Federal grants and contracts are either unaudited or are audited in an uncoordinated, ineffective, and inefficient manner, an approach that costs both time and money.

The Government can lose millions of dollars through gaps in audit coverage, and unnecessary costs result from duplication of effort and from too frequent audits of grants too small to warrant more than occasional audits. Numerous audits also unnecessarily disrupt the grantee's staff. (See ch. 4.)

NEED FOR MORE COMPUTER AUDITING

None of the Federal agencies has adequately audited computer systems. This is a serious deficiency since the Government spends over \$10 billion annually to operate over 10,000 computers. These computers annually issue unreviewed payments and initiate other actions involving billions of dollars in

Government assets. This lack of audit can cost the Government huge amounts. (See ch. 5.)

POOR FOLLOWUP ON AUDIT FINDINGS

Hundreds of millions of dollars may be lost each year because Federal agencies too often delay or take no action to resolve audit findings. Although the actual number of unresolved findings is unknown, one recent GAO report noted that findings from nearly 14,000 audit reports involving \$4.3 billion in 34 agencies had not been resolved. The difficulty of resolving findings varies widely. Although some delays are unavoidable, in most agencies this process is taking too long. Both agency management and internal auditors have important roles in resolving findings. (See ch. 6.)

INSUFFICIENT STAFFING

GAO has been issuing reports since 1966 advocating more staffing for internal audit organizations; although the staffs increased significantly in the 1970s, there has been a strong trend for internal auditors to perform mostly external audits. The result is inadequate coverage of Federal programs. During fiscal 1974-78, agency audit organizations frequently were unsuccessful in obtaining more staff, thereby hampering the efforts of two Offices of Inspector General and probably creating problems for others. Additional staff was unobtainable because

- agencies drastically reduced or did not approve requests for more audit staff,
- the Office of Management and Budget (OMB) and the Congress reduced certain agency requests for audit staff, and
- agencies decreased their audit staffs in response to overall OMB ceiling reductions.

Recently OMB requested more staffing for the Inspectors General in the 1981 budget--which would result in an aggregate increase of 20 percent above fiscal 1979 levels, although

the amounts for individual agencies vary. We cannot now predict how the freeze on Government hiring will affect the planned increase. (See ch. 7.)

CONCLUSIONS

The establishment of the Inspector General Offices and other recent improvements have the potential to strengthen Government auditing, but it is too early to say whether their efforts will correct all deficiencies. (See ch. 8.)

GAO will continue to work with internal audit and Inspector General organizations and will advise the Congress of any further actions needed to solve the problems discussed in this report.

C o n t e n t s

		<u>Page</u>
DIGEST		1
CHAPTER		
1	INTRODUCTION	1
	Benefits of internal auditing	1
	GAO efforts to improve internal auditing	1
2	INTERNAL AUDITORS ARE BECOMING MORE ACTIVE IN COMBATING FRAUD	3
	The Federal Government had not been fulfilling its responsibility to control fraud	3
	Internal auditors have not effectively deterred fraud	4
	Computers make detecting fraud even more complex	5
	Auditors and investigators need better training in identifying fraud	6
3	MANY FEDERAL PROGRAMS LACK ADEQUATE FINANCIAL AUDIT COVERAGE	7
	Objective of financial auditing	7
	More financial auditing is needed	7
	External auditing has received more emphasis	9
4	FEDERAL GRANTS AND CONTRACTS DO NOT RECEIVE ADEQUATE AUDIT COVERAGE	10
	A wide range of problems reduces the effectiveness of contract audits	10
	Grant auditing involves of a maze of problems	11
	Many grants received insufficient coverage	13
	Cross-servicing has seldom been used	13
	Better monitoring of assistance from independent public accountants is needed	14
	Audit coverage of grants and contracts for higher education is inadequate	15
	Quality testing is too superficial	15

Page

5	MORE AND BETTER COMPUTER AUDITS ARE NEEDED IN FEDERAL AGENCIES	17
	Impact of computers	17
	Some internal auditors are contributing to improved computer auditing	18
	Improved audit coverage is needed	18
6	AUDIT FINDINGS ARE NOT BEING PROPERLY RESOLVED	22
	Roles of managers and auditors in resolving findings	22
	Factors contributing to the lack of prompt or effective action	22
7	INTERNAL AUDITING IS IMPAIRED BY INADEQUATE STAFFING AND LACK OF INDEPENDENCE	25
	Inadequate staffing is a widespread, persistent problem	25
	Department of Defense audit organizations have increased their independence	26
8	RECENT ACTIONS TO IMPROVE INTERNAL AUDITING	27
	Current efforts to combat fraud are improving	27
	The status of financial auditing is unclear	27
	Grant auditing is changing drastically	28
	Some Inspectors General have improved computer auditing	29
	Unresolved findings are being addressed	29
	Staffing problems are not resolved	30
9	CONCLUSIONS	31
APPENDIX		
I	GAO reports issued on internal audit systems of Federal and federally assisted programs since June 1, 1975	33
II	Staff sizes of Federal internal audit organizations and Inspector General Offices	40
III	Major areas of financial interest for review by internal audit organizations	43

ABBREVIATIONS

GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
HUD	Department of Housing and Urban Development
OMB	Office of Management and Budget

and investigators indicated a need for more training in such areas as (1) what fraud is, (2) where and how it occurs, and (3) the types and extent of evidence needed to prove fraud.

Since fraud against the Government usually involves financial matters, auditors and investigators need additional expertise in this area. Our 1978 report noted that the qualifying requirements for the criminal investigator position generally included a bachelor's degree or several years of related experience or an equivalent combination of education and experience. However, none of these criteria required experience or training in investigating fraud or knowledge of subject matter often necessary to investigate fraud, such as finance and accounting.

CHAPTER 3

MANY FEDERAL PROGRAMS LACK ADEQUATE

FINANCIAL AUDIT COVERAGE

The time spent by Federal agencies on internal financial audits is often insufficient to adequately cover their assets, liabilities, income, and expenses.

OBJECTIVE OF FINANCIAL AUDITING

According to the Accounting and Auditing Act of 1950, the objective of financial auditing in the Federal Government is internal control. The internal auditor should examine financial transactions to the extent necessary to determine whether:

- The agency is effectively controlling revenues, expenditures, assets, and liabilities.
- It is properly accounting for its resources, liabilities, and operations.
- Its financial reports contain accurate, reliable, and useful data and are fairly presented.
- It is complying with laws and regulations.

The internal auditor should evaluate the agency's policies and procedures and the internal controls related to its financial operations, including accounting and financial reporting. He or she should be particularly concerned with the agency's assets--whether they are fully accounted for and whether procedures are being followed to adequately protect them from loss, deterioration, or misuse. Appendix III specifies financial areas that should be reviewed, as applicable, by an agency's internal audit staff.

MORE FINANCIAL AUDITING IS NEEDED

In May 1977 Senator Lee Metcalf, then Chairman of the Subcommittee on Reports, Accounting and Management, Senate Committee on Governmental Affairs, asked us to obtain information on financial audits of each organizational unit of the executive branch of the Federal Government. Specifically, he wanted to know who had audited each unit during fiscal 1974-76.

In response, we reported in June 1978 that 133 Federal units with annual funding exceeding \$20 billion had told us

they had not received financial audits during fiscal 1974-76, although 58 had reported they had received nonfinancial audits. Although some of these funds were budgeted for Federal assistance programs which are often audited at State or local levels, the Federal disbursing units involved were not included in these audits.

Our reviews during fiscal 1976-78 concerning the extent of internal financial auditing in seven major agencies disclosed that the Departments of Housing and Urban Development (HUD) and Agriculture were generally providing adequate audit coverage of internal financial operations. For various reasons, the other five agencies lacked such coverage. We found:

- The Department of Labor's auditors had provided virtually no internal financial coverage because external audits of grants under the Department's Comprehensive Employment and Training Act Program had been given primary emphasis.
- Veterans Administration auditors had focused on audits of the agency's hospitals and had not adequately covered all internal financial operations. They had provided only sparse coverage to the multibillion-dollar veterans benefit programs, which constituted 74 percent of the Veterans Administration's fundings.
- The Department of the Interior's auditors, except for audits of the Bureau of Land Management and the Bureau of Reclamation, had not provided sufficient coverage of the Department's internal financial operations.
- The National Aeronautics and Space Administration's audit staff had provided virtually no coverage to headquarters operations or to several field centers and component installations.
- The Department of Justice had placed primary emphasis on financial audits of the Federal Prison System and only limited financial audit coverage had been provided in the other program areas.

The lack of financial audit coverage in most instances stemmed from a lack of audit personnel. In addition, decisions on establishing audit priorities have resulted, in some cases, in the shift of limited staff to external audits. For example, Labor officials told us they had emphasized external audits because of the significant dollar amounts appropriated to such programs. The Director of Justice's Internal Audit Staff stated that his office's concentration on Federal Prison System audits had stemmed from the fact that for the first

4 years of its existence, his office had to depend almost entirely on reimbursement from the groups it audited to fund its operations. Thus, about 65 percent of its reports were on the Federal Prison System, which provided the largest share of the reimbursement during that period. The Veterans Administration's concentration on hospitals also stemmed partially from the fact that its Internal Audit Service had not developed its universe of programs to be audited and had not filed its plans for auditing that universe with OMB. Lacking a defined universe and a formal plan, the Service had been following a longstanding policy of concentrating on hospitals.

EXTERNAL AUDITING HAS RECEIVED MORE EMPHASIS

Many agencies are spending most of their audit effort on external audits of grants and contracts. As a result, some internal audit coverage, particularly financial coverage, has not been adequate. The trend toward more external auditing was pointed out in our 1976 report. It stated that HEW spent 80 percent of its audit time on external audits; HUD, 64 percent; and the Department of Transportation, more than 70 percent.

Although we recognize the need for adequate external audit coverage and the problems experienced in attaining it--as discussed in chapter 4--we believe the resulting lack of emphasis on internal financial auditing represents a serious weakness.

CHAPTER 6

AUDIT FINDINGS ARE NOT BEING PROPERLY RESOLVED

Hundreds of millions of dollars may be lost each year because Federal agencies too often delay or take no action to resolve audit findings. Although the actual number of unresolved findings is unknown, our October 1978 report noted that \$4.3 billion in audit findings, contained in nearly 14,000 audit reports of 34 agencies, had not been resolved.

ROLES OF MANAGERS AND AUDITORS IN RESOLVING FINDINGS

The difficulty of resolving findings varies widely, and although some delays are unavoidable, in most agencies this process is taking too long. Both managers and auditors have important roles in resolving findings, as discussed below.

Management's overall responsibility for resolving findings is spelled out in OMB Circular A-73. In addition, OMB Circulars A-88 and A-102 provide specific guidance on audit followup for Federal assistance programs. Circular A-73 requires that managers promptly decide what should be done and complete corrective measures as necessary on findings. The circular requires agencies to (1) determine agency action on audit recommendations within 6 months after they are made and (2) periodically evaluate their followup systems.

The internal auditor's role is stated in GAO's Policy and Procedures Manual for Guidance of Federal Agencies, which has similar requirements. The manual also states that auditors should participate in the followup activities to see if their findings have received serious management consideration and whether satisfactory corrective action has been taken. It further states that when operating officials disagree with auditors' findings, a decision should be made at a higher management level.

FACTORS CONTRIBUTING TO THE LACK OF PROMPT OR EFFECTIVE ACTION

Although established procedures require agency administrators to promptly and effectively resolve audit findings, our 1978 report stated that they often had not done so because:

- Administrators were busy with other duties and resolving findings had low priority. Department and agency heads generally did not emphasize to employees the importance of audits as a means of safeguarding funds and improving Government operations.

--Administrators rejected findings and recommendations without suitable justification and did not always seek needed legal or other expert advice.

--Agency efforts to recover funds and realize savings were not aggressive. Basically they did not insure collection action by establishing accounting and collection control over amounts to be recovered from grantees and contractors.

--Agency systems for tracking and resolving findings were deficient.

--Deficiencies in auditors' work sometimes made prompt and effective action difficult. Also, auditors could have done more to see that action was taken on their findings. More specifically, they did not always (1) fully develop findings, (2) issue prompt reports, and (3) verify or question the adequacy of administrators' corrective actions.

Systems for Tracking and Resolving Findings Are Inadequate

Most agencies were not complying with OMB requirements, and few had adequate systems for tracking and resolving findings. In addition to our 1978 review, other audits over the past 4 years have addressed aspects of this problem repeatedly.

We have issued several reports in recent years pointing out that agencies have often failed to establish formal followup systems. Examples follow.

- The Naval Audit Service did not have a formal system to effectively track the progress of findings and recommendations after reports had been issued. The Audit Service's large number of repeat findings indicated the inadequacy of both management's implementation of recommendations and its followup procedures.
- Because of its limited staff, the Small Business Administration did not conduct specific followup reviews.
- The Department of Defense contracting officers did not provide required feedback on recommendations, nor did they always use Defense Contract Audit Agency findings when negotiating contract prices. Action taken on 22,500 audit reports was unknown.

--The National Science Foundation did not follow up on its recommendations, and many were not resolved or the actions taken were untimely.

--The Defense Audit Service was not using a systematic method for following up on recommendations, and there was no assurance that followup would be accomplished even on significant matters.

--The General Services Administration's followup system needed considerably greater management emphasis--by the agency and OMB--and more prompt and systematic review by internal auditors to provide any assurance that promised corrective actions were actually taken or that the reported problems were otherwise satisfactorily resolved.

Agencies allowed findings to go unresolved because their systems did not track resolutions to final settlement. Management and audit officials often remove findings from control records and consider them resolved when grantees or contractors agree with them and promise to take corrective actions. In addition, administrators often forget or overlook final settlement when findings are prematurely dropped from tracking systems, and top managers assume that the findings were completely resolved when sometimes they were not. In some cases proper resolution of findings could have been facilitated if agency auditors had reported complete findings, issued prompt reports, and determined and questioned the adequacy of management's corrective actions.

CHAPTER 7

INTERNAL AUDITING IS IMPAIRED BY

INADEQUATE STAFFING AND LACK OF INDEPENDENCE

Our past reports have pointed out numerous weaknesses in the staffing of internal audit groups. We have long supported a strong Federal internal audit capability in recognition of the important role it plays in preventing and detecting fraud, waste, and abuse.

INADEQUATE STAFFING IS A WIDESPREAD, PERSISTENT PROBLEM

We have been issuing reports since 1966 on the need for increased staffing for internal audit groups, and although audit staffs increased significantly in the 1970s, there has also been a strong trend for internal auditors to do mostly external audits. As a result, even with increased staffs, internal auditors are still not adequately covering Federal programs.

In 1976 we reported that several agencies had not established internal audit staffs whereas others had staffs which were too small. We reported in 1979 that agency audit organizations frequently had been unsuccessful in obtaining more staff and that this situation was hampering the efforts of two Offices of Inspector General during fiscal 1978 and would probably create problems for others. Agencies could not obtain more staff during fiscal 1974-78 primarily because

--agencies drastically reduced or did not approve requests for more audit staff,

--OMB and the Congress reduced certain agency requests for audit staff, and

--agencies decreased their audit staffs in response to overall OMB ceiling reductions.

This lack of resources adversely affects many areas in the internal audit function. For example, in most instances when we found a lack of financial audit coverage, it stemmed from a lack of personnel. In 1977 we reported that limited staffing was a barrier inhibiting the implementation of additional cross-service auditing. In addition, our recent report on grant auditing cited the shortage of audit resources as the principal reason given by Federal agencies for insufficient grant audit coverage. Federal auditors also stated